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Delaware Supreme Court Confirms Forfeiture-for-Competition Provision Is Governed by Employee Choice Doctrine Rather Than More Restrictive Non-Compete Analysis

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On January 24, 2024, the Delaware Supreme Court re-opened the door for employers to rely on the employee choice doctrine to support forfeiture-for-competition provisions as an alternative to traditional non-compete agreements. The employee choice doctrine applies when a departing employee has a choice between (1) abiding by a non-compete provision and keeping post-employment compensation from the former employer or (2) working for a competitor and forfeiting that compensation. In *Cantor Fitzgerald, L.P. v. Ainslie*, the Delaware Supreme Court reversed a Delaware Chancery court decision that erased the distinctions between a forfeiture-for-competition provision and a traditional non-compete. In doing so, the Delaware Supreme Court held that a forfeiture-for-competition provision in a limited partnership agreement was distinct from, and not subject to the same judicial analysis as, a traditional post-employment non-compete provision.

The employee choice doctrine presumes that employees who leave voluntarily make informed choices to preserve their contractual rights to a post-employment benefit or to forfeit those rights by competing with the former employer. Because the employee has a choice and is not actually precluded from competing, courts in many states, including Delaware, have not subjected these types of provisions to the same strict scrutiny and reasonableness requirements as traditional non-competes.

Traditional non-competes prohibit employees from competing with their former employers. The employer can seek an injunction preventing the former employee from working for a competing business. These provisions are viewed as restraints on trade and are carefully scrutinized by courts. Typically, courts in many states will enforce non-competes if they are reasonable in scope, duration, and geographic reach; are narrowly tailored to protect the employer's legitimate business interest in confidential information, trade secrets or good will; and do not impose an undue burden on the employee's ability to earn a living.

Under the employee choice doctrine, however, forfeiture-for-competition and similar provisions are treated differently. Courts applying the employee choice doctrine typically evaluate forfeiture-for-competition provisions under a more relaxed standard or will simply enforce the provision as a product of an agreement between two contracting parties. The rationale for this is that these provisions do not actually prevent former employees from competing and earning a living in their chosen field. Rather, the provisions incentivize former employees to choose to refrain from competing by providing a carrot instead of a stick: by not competing, former employees are entitled to certain post-employment benefits. The employee is free to compete, but then they do not get the carrot.

This was the Delaware Supreme Court's reasoning in *Cantor Fitzgerald*. The agreement provided for payouts to a limited partner each year for four years after the limited partner left the limited partnership. The payouts, however, were contingent on the limited partner not competing. The court held that forfeiture-for-competition provisions like this "do not prohibit employees from competing and remaining in their chosen profession, and do not deprive the public of the employee's services." Thus they "present no such concern" about the public policy interests that lead to careful scrutiny of traditional non-competes. That is particularly true when sophisticated parties bargain for post-

employment benefits contingent on not competing with the former employer. The court also noted that Delaware's Limited Partnership Act provides for freedom of contract in partnership agreements.[1] The Delaware Supreme Court concluded that the forfeiture-for-competition provision should be enforced without regard to reasonableness as long as there was not "unconscionability, bad faith or other extraordinary circumstances."

With this decision, Delaware rejoins other jurisdictions that recognize the employee choice doctrine and assess the viability of forfeiture-for-competition provisions using a different standard than for traditional non-competes. Different states, however, have varying approaches to the employee doctrine. For example, New York courts recognize the employee choice doctrine where an employee leaves voluntarily and the employer was willing to continue the employment relationship. Since New York courts view this as an exception to the general rule disfavoring non-compete provisions, they often do not examine forfeiture-for-competition provisions for reasonableness.[2] Texas applies the employee choice doctrine to distinguish forfeiture-for-competition provisions from traditional non-competes, but the Texas Supreme Court has left open the possibility that a forfeiture-for-competition provision nonetheless must be reasonable.[3] Some jurisdictions, like Florida, emphasize that a forfeiture-for-competition provision can only apply to unvested benefits or compensation and that a contract providing for forfeiture of vested rights if the employee competes must be analyzed under the traditional reasonableness test for non-compete agreements.[4]

The recent Delaware Supreme Court decision confirms that the employee choice doctrine remains a viable option in many states[5] for employers who seek to limit post-employment competition by conditioning certain post-employment benefits on non-competition. A thorough analysis should go into determining whether a forfeiture-for-competition provision is a feasible option for particular employers and employees, and careful attention should be paid to drafting an effective provision that is likely to be enforceable under the relevant state laws.

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[1] The court also noted that Delaware law authorizes forfeitures in partnership agreements that might not be allowed in other contracts.

[2] *See Morris v. Schroder Capital Mgmt. Int'l*, 7 N.Y.3d 616, 620-21 (2006);*Lucente v. Int'l Bus. Machines Corp.*, 310 F.3d 243, 254-55 (2d Cir. 2002).

[3] *Exxon Mobil Corp. v. Drennen*, 452 S.W.3d 319, 328-29 (Tex. 2014) (holding that a contract providing for forfeiture of restricted stock units if employee is disloyal (including by competing after employment) is not a traditional non-compete, but reserving for a future day the issue of whether they may be subject to reasonableness review).

[4] *See Flammer v. Patton*, 245 So. 2d 854, 856-60 (Fla. 1971) (analyzing a forfeiture-for-competition provision governing pension payments for reasonableness under the then-existing Florida non-compete statute); *Barr v. Sun Life Assurance Co.*, 200 So. 240, 243 (Fla. 1941) (provision causing employee to forfeit unvested, post-employment commission payments if the employee competes "is not a contract in restraint of trade"); *Fischer v. Blue Cross & Blue Shield of Fla.*, 2021 Fla. Cir. 14244, *4-9 (Fla. 1st Cir. Dec. 9, 2021) (citing *Flammer* and *Barr* and noting difference in treatment of forfeiture of vested versus unvested benefits under the current Florida non-compete statute).

[5] The National Labor Relations Board recently suggested that some non-competes may violate the National Labor Relations Act by discouraging protected employee activity, and it remains to be seen if the NLRB will take the position that forfeiture-for-competition provisions with employees who are not supervisors are invalid under that statute on the federal level.

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